



TO: Bert van der Vaart, President
Small Enterprise Assistance Funds

FROM: David Lingelbach
Executive Director
Institute for SME Finance

DATE: September 18, 2002

SUBJECT: Program Report for Sub-Grantee, Institute for SME Finance

In accordance with Grant Agreement # PER-G-00-00-00019-00 (the "Grant") between USAID and Small Enterprise Assistance Funds (SEAF), the Institute for SME Finance (the "Institute") is herewith providing to the Grantee, SEAF, a Program Report for the third six months of activities under the Grant (September 18, 2001 through March 17, 2002).

Activities for the Period

During the reporting period, the Institute began to refocus its efforts on two core activities: education and training, and advisory services, with a special focus in the latter on advocacy and implementation of a new business model of SME finance. As a result, and in consultation with its board of directors, the Institute decided to defer implementation of the other aspects of its original operating plan, including membership services and an annual Practitioners Forum.

As part of its continued expansion of its training program, the Institute conducted two workshops on SME risk capital finance during the reporting period:

- A two-day workshop on SME equity investing in Bombay, India in February 2002, sponsored by IFC, and;
- A two-day seminar on investing in emerging enterprises in Santiago, Chile in October 2001, sponsored by the Chilean Ministry of Finance.

As part of its continuing development of a stock of case studies on SME finance, the Institute sponsored the completion of one case study on risk capital investment in SMEs during the reporting period. This case study examines the challenges of exiting from SME equity investments from the perspective of a Czech private equity fund and its investment in a ceramic refractory producer. A second case study, examining the issues of structuring an investment in an Indian forms processing concern, was initiated during the reporting period.

The Institute now has a sufficient stock of case studies (including those commissioned by others, but available to it) to commence a one-week case study-based course in SME risk capital finance. During the

reporting period, work on the curriculum for this course began. The inaugural course will take place in late September 2002 in Trinidad and Tobago, sponsored by the Trinidadian government.

However, the Institute has now exhausted the bulk of its establishment grant funding for case study development. The development of new case studies is critical to the continued growth of the Institute's education and training program. Feedback from participants in the Institute's training courses indicates that participants gain more from case studies tailored to their local conditions, although they still derive significant benefit from cases that cover those universal principles of SME finance. The stock of cases available to the Institute is especially weak in the following geographical areas: Africa, the Middle East, and Asia. The Institute is in the process of developing additional sources of funding to support an expansion of the stock of SME finance case studies available to it.

As in previous reporting periods, the Institute or its officers engaged in a number of paid advisory assignments. As before, this advisory work was undertaken in order to 1) provide cash flows in support of the Institute's financial sustainability strategy, 2) broaden the knowledge base of the Institute and its officers, 3) continue the process of identifying both obstacles and best practices in SME finance, and 4) establish awareness of the Institute as a formal organization having in-house expertise. In addition, paid advisory assignments are also becoming an important source of case study material for the Institute's education and training activities.

<u>Assignment</u>	<u>Sponsor</u>
Development of a strategy for improving SME access to equity capital in China (commenced July 2001-ongoing)	Asian Development Bank via Pragma Corporation
Continuing recommendations for steps to mobilize the creation of a local venture capital sector in Namibia (February 2002)	USAID
Recommendations concerning SME access to finance in Rwanda (February 2002)	World Bank Group
Design of new ways to mobilize USAID's Development Credit Authority in order to increase the flow of risk capital to SMEs (March 2002)	USAID
Feasibility study for an SME risk capital fund in Pakistan (commenced March 2002-ongoing)	Asian Development Bank

In addition, Institute staff spoke at conferences on SME finance in Trinidad and Mexico during the period, for which the Institute was paid. Institute staff also participated in the IFI Working Group meetings in Paris in January 2002. As part of its continuing research into best practices in SME risk capital finance, Institute staff traveled to South Africa in February 2002 to meet with Business Partners, an innovative SME finance organization.

Total grant and contract revenues from the above completed workshops and assignments were \$108,491. In addition to these assignments, the Institute received the following disbursements under previously committed grants during the reporting period:

<u>Grantor</u>	<u>Amount</u>	<u>Status</u>
IFC	\$300,000 over 3 years	\$100,000 disbursed October 2001

Plans for the Remainder of FY2002 and FY2003

Having completed 27 assignments or training events in 21 countries in Latin America, Africa, Asia, the former Soviet Union, and the Middle East since its inception, the Institute is now prepared to draw some initial conclusions concerning both best practices and lessons learned in the field, and to share those conclusions with fund managers, investors, and governments.

The Institute will do so by focusing on the following activities:

- Education and training of current and potential fund managers, investors, governmental officials, and entrepreneurs, and;
- Advocacy of fresh approaches to SME risk capital finance

Education and training of fund managers, investors, governmental officials, and entrepreneurs

The Institute's new Education and Training Program represents a significant expansion from its modest training efforts over the past two years. This expansion reflects the growing demand for specialized, high quality training in various aspects of SME finance, as well as the linkages between training in SME risk capital finance, other forms of SME finance (such as SME banking), and training of entrepreneurs in corporate governance and related issues, such as capital-raising. The new Program has been designed to take account of these linkages and the needs of various segments of the Institute's constituency.

The Program consists of the following elements:

- SME Finance 101—Under this introductory element, two activities will be conducted:
 - The Practitioners Forum will be refocused as an entry-level training event targeting new fund managers or potential entrants to the field, such as graduate students. It will be held approximately every two years, depending on demand and funding.
 - Introductory workshops will be conducted on a demand basis in those countries where the principles of SME finance are still relatively new. These workshops will generally be 1-2 days in length and modeled on the Institute's previous workshops in Brazil, Central Asia, Chile, India, and Namibia.
- SME Finance 201—Case based courses. Case based courses are expected to be the core of the Institute's training curriculum for the foreseeable future. Three courses are contemplated at present:
 - SME Risk Capital Finance—this five day course will be launched in late September 2002 in Trinidad and Tobago and offered in both Washington and

abroad four to six times each year. Target participants are current fund managers and senior-level financial executives from potential fund sponsors, investors, and, to a limited degree, government officials. The course is an intensive examination of the investment process through the use of approximately ten case studies in SME finance and other topics drawn from throughout the developing world¹. The Institute has either prepared or commissioned approximately 50% of the cases used in this course; the other 50% are cases commissioned by the Multilateral Investment Fund of the Inter-American Development Bank. The mix of case studies used in this course will continue to evolve as new cases are prepared.

- SME Lending—the Institute’s research into best practices over the past two years has revealed that poor lending practices limit the ability of many SMEs to grow. Many bankers in developing countries continue to rely heavily on collateral-based approaches to credit. As a result, SME risk capital funds, which are designed primarily to offer equity and quasi-equity financing, find themselves more and more in a position where they are financing the working capital and trade finance needs of their investees, elements of finance for which they are not well prepared. Moreover, many SME bankers in developing countries are now being encouraged to use techniques common in developed countries (such as credit scoring), which may also be inappropriate.

Using its experience from previous and current advisory assignments, and with the working assumption that providing credit to SMEs in developing countries can be strikingly similar to equity investing, the Institute intends to develop a case study-based course in SME lending. This course will be targeted at junior level SME bankers in developing countries and will cover such topics as initial client assessment, determining an SME’s financial needs, cash flow forecasting, relationship management, and raising additional outside capital for clients.

- Capital Raising—The Entrepreneur’s Perspective—the Institute’s initial operating plan called for it to offer training to entrepreneurs focused specifically on corporate governance issues as they relate to SME risk capital investment. Based on feedback received from participants in the Institute’s past training events, we are now developing a broader course that, in addition to corporate governance issues, will examine the capital-raising process from the perspective of the entrepreneur. While this course will be targeted primarily at SME entrepreneurs (with a special emphasis on those that have already received an outside risk capital investment), it will also be beneficial to current fund managers seeking to improve their deal flow development.
- SME Finance 301—Advanced topical courses. These courses are expected to be case-based courses of from one to three days in duration, addressing more advanced material of current interest to fund managers. Initial topics for these courses may include valuation of SME risk capital investments, restructuring SME investments, post-investment support, and establishing and managing an SME fund’s back office.

¹The current stock of case studies available to the Institute includes cases from Argentina, Bolivia, Brazil, Bulgaria, Czech Republic, El Salvador, India, the Middle East, Peru, Russia, and Uzbekistan

In addition to this core curriculum, the Institute may also be called upon to assist with training for the possible SME Investment Company initiative (see below).

Advocacy of fresh approaches to SME risk capital finance

Based in part on the preliminary conclusions it has reached about the state of SME risk capital finance (and which were described in the last program report), the Institute moved forward during the current reporting period with the implementation of a pilot program in Namibia concerning the establishment of SME Investment Companies. The Namibian government and the USAID mission in Namibia have sponsored this initiative.

Based on the experience to date with the Namibian initiative, the Institute has recommended the establishment of similar such programs in other African countries, and active discussions are now underway regarding a possible regional initiative regarding SME Investment Companies, sponsored by a major development finance institution.

Outside of Africa, while the SME Investment Company model cannot be universally applied to all countries and all stages of investment, the Institute has selectively recommended variations on this model in its advisory work, notably in Pakistan.

We remain grateful to USAID and to the Grantee, SEAF, for their generous support during the Institute's startup period.

Sincerely,

David Lingelbach